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REAL ESTATE

Vol. 2, No. 5 May 1989

OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- According to the U.S. Department of Commerce, real GNP expanded at an annual rate of 5.5 percent in the first quarter of 1989, the fastest rate of growth since the fourth quarter of 1987. Non-farm real GNP growth grew at an annual rate of 3.0 percent, down from 3.5 percent in the fourth quarter of 1988.
- Consumption growth slowed in the first quarter due to a growing apprehension towards borrowing on the part of the consumer. This has translated into a large drop in consumer spending on big-ticket items, especially for automobiles and light trucks.
- In the first 3 months of 1989, the personal savings rate has skyrocketed, jumping to a four year high in March of 6.3 percent.
- The GNP price index (fixed weights) rose 5.0 percent in the first quarter, while the consumer price index rose at an annual rate of 6.3 percent from December 1988 to March 1989.
- In just two months, housing starts have fallen 16.7 percent to an annual rate of 1.397 million units. Single-family units alone fell 17.1 percent over the course of February and March to the slowest rate since January of 1985.
- Sales of new single-family homes fell for the second consecutive month in March to a seasonally adjusted annual rate of 587 thousand units. The combined two month fall left home sales 15.4 percent lower than the January annual rate of 694 thousand units.
- Existing single-family home sales dropped 4.3 percent in March to a seasonally adjusted annual rate of 3.33 million units. In the first quarter of 1989, existing home sales reached an annual rate of 3.45 million units, down 8.5 percent from the 1988 fourth quarter rate of 3.77 million units.
- The latest 1.3 percent increase in the median price of an existing single-family home marked the fourth consecutive monthly rise, boosting the median sales price of an existing home to an all-time high of $93,100 in March.

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Forecasting & Policy Analysis Division
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THE ARISTOTELIAN ECONOMY

Economic Commentary

by
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For the mean-spirited and curmudgeonly in the economics and finance community, it could be the worst of times. Since November of 1987--fully nineteen months--cries and alarms of recession, skyrocketing interest rates and hyperinflation have filled the newspages and the airways. But, at every single turning point the economy failed to go off the deep end, but rather returned to this monotonous path of modest growth and moderate interest rates that it has followed since 1982.

The most recent example has been the interest rate rise generated by the Federal Reserve over the past year, in an attempt to slow down the economy. Yes, rates have risen; yes, inflation is up a bit. But in neither case is disaster evident, as both rates are peaking out well short of their feared potential. In fact, the Fed is just about ready to strike the flag, declare the battle won, and withdraw in orderly fashion to pursue other pressing issues.

Why? How come this economy is reaching the edge of the abyss and then pulling itself back before plunging in, as it did so often during the Seventies? Economists ascribe this behavior to the phenomenon of "rational expectations." Quite simply (an oxymoron when juxtaposed with any economic theory), information about the shape of coming events is so widely known that economic agents act as if the events have happened and thus blunt their impact. Or, as the Lord High Executioner Ko-ko explains in the final scene of "The Mikado" in an effort to save his neck, "When your majesty orders a thing done, it's as good as done. And as this is so, why bother doing the thing at all?"

More practically, information technology has advanced to the stage where financial markets operate with an efficiency previously undreamed. They anticipate both economic events and economic policy and move to profit from this anticipation. When that occurs, the effect of the event becomes less. Thus, if the market perceives that the Fed is pushing rates up it will sell off long term securities producing the result desired by policy more quickly and efficiently. Consequently, the ultimate goal of policy--the slowing of the economy --is achieved with a smaller rise in rates than anticipated. This growing sophistication in financial markets combined with an older and more productive labor force has been the key to the run of moderate prosperity we have seen in this economy.

Does this mean that business cycles are no more? Hardly, steady growth has occurred in an environment where policy makers and the public are unwilling to come to grips with a major weakness in the economy that could in fact bring down the house. During this run of economic splendor, we have exalted profligacy over thrift both personally and publicly. Sharply higher public and private debt suggest we are modelling ourselves after a line from Richard Penniman (aka Little Richard), "I don't care how I spend my gold, tonight I'll be one happy soul." Moreover, the recent budget agreement between the Administration and the Congress is more smoke and mirrors, rather than a serious effort to deal with a serious problem.

There is a theory that a continuing budget deficit is good discipline in that it prevents any interest rate or inflation surges that will pop the budget balloon. While this is a little like suggesting that cancer is good because it forces you to eat right, it still represents yet another potential source of moderating tendencies in this economy. Of course, without the deficit, we would still have an essentially self-correcting economy, but interest rates and inflation might well be lower.

Although my many years of Jesuit Training developed in me a respect for great ideas, I've always found more sense in Aristotle's counsel toward moderation than in the extremism of Plato. What we have seen over the past seven years is the economic equivalent of that approach to life. For a variety of reasons, we have become very much an Aristotelian economy, where the golden mean is the common state of affairs. In the long run, this moderation is healthier for the economy, can accommodate the kinds of long-term demographic and geopolitical changes we are facing and will allow us to sustain growth longer. And moderation is an ideal that I, for one, will defend to my last drop of blood!

Outlook for the Economy and Real Estate

ECONOMIC OUTLOOK

According to the U.S. Department of Commerce, real GNP expanded at an annual rate of 5.5 percent in the first quarter of 1989, the fastest rate of growth since the fourth quarter of 1987, when growth was 6.1 percent. However, a substantial part of this growth rate is a 2.5 percentage point drought-related adjustment factored in by Commerce Department economists. Most of this adjustment fell into the category of farm inventory investment, as farmers are expected to replenish inventories depleted during the 1988 drought. Netting out this drought adjustment, non-farm real GNP growth (the rate which most analysts, including those at the Federal Reserve, are concerned with) grew at an annual rate of 3.0 percent, down from 3.5 percent in the fourth quarter of 1988. While the present slowdown may be more gradual than the monetary authority would have preferred, the Fed is most likely pleased with this report and other, more recent, evidence that the economy is slowing down. Many of the March indicators bear witness to this economic retreat, with housing starts and home sales falling, capacity utilization retreating, and retail sales and durable goods orders growing modestly after months of decline. This trend of modestly slower growth is expected to continue in the coming months, as real GNP growth slows to 2.2 percent in both the second and third quarters, and 1.8 percent in the fourth.

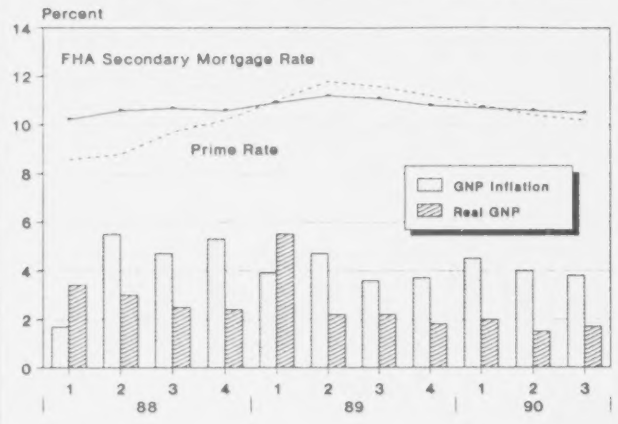
Consumption Growth Slows

A closer look at the composition of GNP growth reveals an encouraging change: voracious consumer spending yielding to stronger business fixed investment and net export growth. This sign of slowing growth in consumer demand could be the pause that refreshes the nation's overburdened factories, relieving the trend towards rising prices. Less capacity devoted to domestic consumption goods could allow for increased production of exported goods, which would help trim the trade deficit. Another positive indicator in the GNP report was accelerated business outlays on structures and equipment, which generally fall during times of high interest rates. By escalating fixed investment, businesses are laying the foundation necessary for future increases in productivity. This in turn enhances U.S. firms' ability to compete with foreign firms, and reduces the chances of future capacity shortages and bottlenecks.

Autos Become a Hard Sell

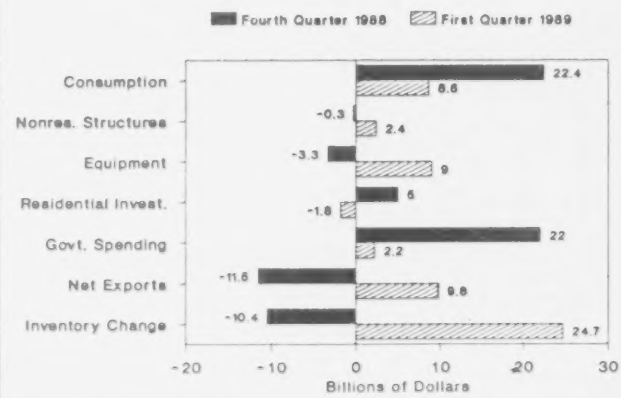
The consumption slowdown of the first quarter was fueled mainly by growing apprehension towards borrowing on the part of the consumer. This has translated into a large drop in consumer spending on big-ticket items, especially for automobiles and light trucks. Between December 1988, and March 1989, sales of domestic autos fell 21.0 percent from a seasonally adjusted annual rate of 8.4 million to 6.6 million cars. During the first 10 days of April, car dealers managed to raise the sales rate to 7.6 million units (about level with the sales rate set last April), but only after offering expensive rebate programs and cut rate financing (as low as 0.0 percent in some cases). The outlook for car sales through the rest of 1989 is mixed, as high interest rates may force the auto companies to continue these expensive incentive programs; programs which have a tendency to borrow from future auto sales rates.

GRAPH 1: THE ECONOMIC OUTLOOK



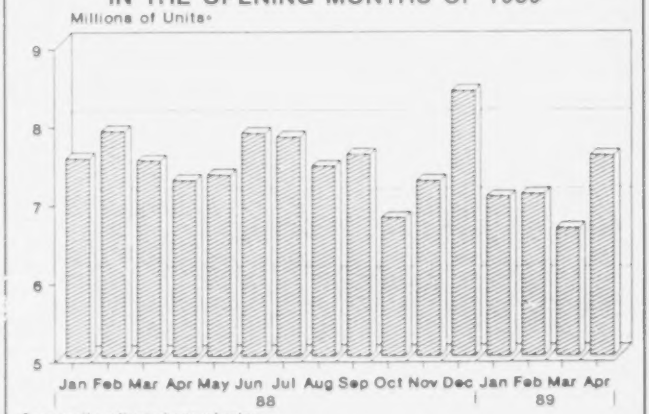
E NAR estimates

GRAPH 2: THE COMPOSITION OF REAL GNP GROWTH



Source: The Department of Commerce

GRAPH 3: AUTO SALES ARE SLUGGISH IN THE OPENING MONTHS OF 1989



*Seasonally adjusted annual rates
Note: The Apr 89 rate is based on the first 10 days of April
Source: The Bureau of Economic Analysis

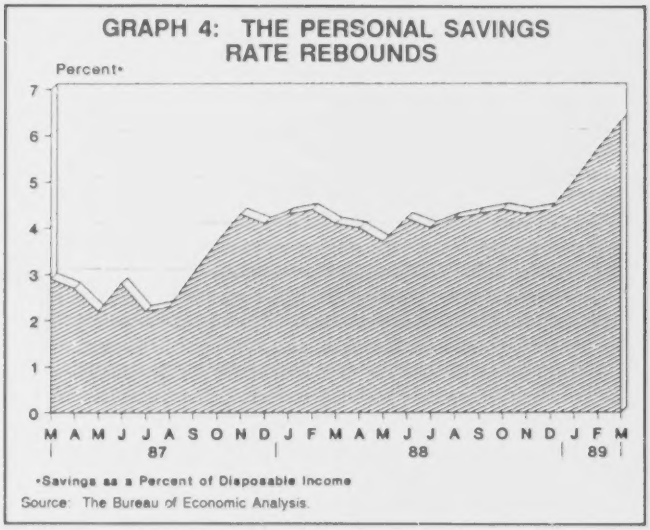
Saving Is Back In Style

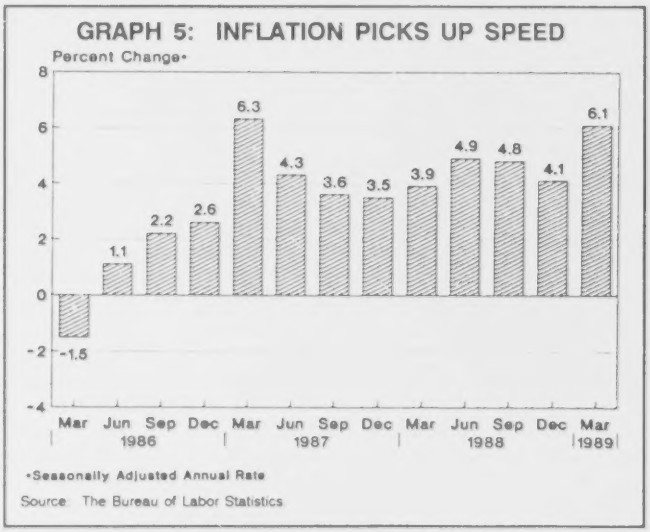
The recent slowdown in consumer spending has cast doubt on the now familiar argument that Americans have forgotten how to save. Concerns surrounding this country's diminishing rate of savings peaked in May of 1987, when the savings rate (savings as a percent of disposable income) fell to an all time low of 2.2 percent. Savings made a gradual comeback during the remainder of 1987, and by 1988 the rate had reached 4.0 percent. However, in the first 3 months of 1989, personal savings have skyrocketed, jumping to a four year high in March at a rate of 6.3 percent. Rising interest rates, which have slowed the demand for big-ticket consumer durables like automobiles, have in turn encouraged savings. Moreover, many analysts point out that the leading edge of the baby boom generation, which fueled the consumption splurge of the past decade, has reached the age of higher income and saving rates. If true, this could mean that a higher level of thrift resembling historical patterns is coming back into vogue. Of course, one quarter's data is too brief to mark the beginning of such a change. However, a higher portion of income devoted to saving would go a long way to helping cure some economic problems: aid the long process of adjusting the trade imbalance and reduce reliance on foreign capital to fund the domestic budget deficit.

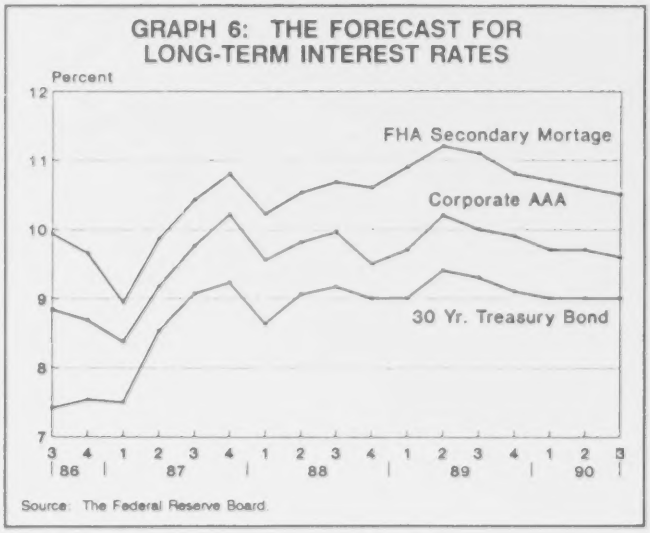
So far, 1989 has been a year of surprising economic growth that now appears to be yielding to a slower, more sustainable pace. Seven years of economic expansion have built up significant capacity constraints, a greater potential for wage escalation, and as a result, a generally higher level of producer and consumer prices. Most recently, the GNP price index (fixed weights) rose 5.0 percent in the first quarter, while the consumer price index rose at an annual rate of 6.3 percent from December 1988 to March 1989. It is fairly common for prices to continue rising after the economy begins to slow, as it can take several months of slow growth for the bottlenecks and shortages, which contributed to the faster rates of inflation, to subside. Therefore, we should not expect prices to turn downwards as soon as the pace of economic growth slows. Rather, we expect to see some relief in prices late this summer, provided there are no unexpected shocks to the economy, such as a repeat of the 1988 drought or a surge in energy prices.

MONETARY POLICY AND INTEREST RATES

The rising rate of inflation has raised concerns that the Fed may need to squeeze credit a bit more and nudge interest rates higher in order to further slow economic growth. However, given the number of recent monthly indicators that suggest the economy has slowed more than the GNP report indicates, the Fed is believed to be sitting tight, waiting for more information on the economy's course. In this enviornment, short-term rates have drifted lower in the past month, allowing the yield curve to flatten somewhat. However, short-term rates have not fallen below the yield on long-term government bonds, leaving the yield curve inverted. If the popular economic barometers continue to suggest a slowdown in real GNP growth to the 2.0 to 2.5 percent range, interest rates are expected to follow suit. We believe that interest rates are now close to what will likely be their highest levels in 1989, and we expect them to fall noticeably by the summer's end.







HOUSING STARTS

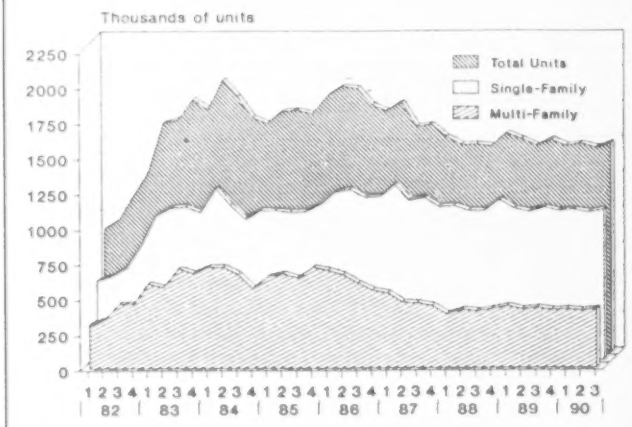
(Seasonally Adjusted Annual Rates, in Thousands)

		Total	S-F	2-4	5 and up
Mar	1989	1397	994	48	355
Feb	1989	1476	1034	56	386
Jan	1989	1678	1199	66	413
Dec	1988	1577	1141	65	371
Mar	1988	1528	1169	57	302
March 1989 Percent Change From:					
Feb	1989	-5.4%	-3.9%	-14.3%	-8.0%
Mar	1988	-8.6%	-15.0%	-15.8%	17.6%

		Northeast	Midwest	South	West
Mar	1989	149	307	546	395
Feb	1989	226	278	573	399
Jan	1989	293	313	642	430
Dec	1988	210	343	609	424
Mar	1988	284	261	574	409
March 1989 Percent Change From:					
Feb	1989	-34.1%	10.4%	-4.7%	-1.0%
Mar	1988	-47.5%	17.6%	-4.9%	-3.4%

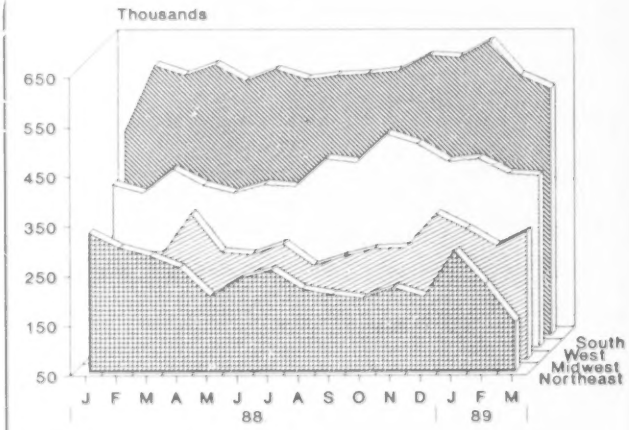
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: The Bureau of Census; E NAR Estimates

GRAPH 8: HOUSING STARTS BY REGION



Source: The Bureau of Census

In the past two months housing starts have proven the old cliche (as well as the law of gravity) that what goes up must come down. When housing starts began their climb back in September of 1988, which culminated in January 1989 at a 16 month high, most analysts stepped back and waited for the fall. In just two months, housing starts have fallen 16.7 percent to an annual rate of 1.397 million units. Single-family units alone fell 17.1 percent over the course of February and March to the slowest rate since January of 1985. It seems that higher mortgage rates, particularly higher rates on adjustable mortgages, have put a damper on housing activity. The good news is that further interest rates increases, if any, are expected to be modest. However, slower economic growth is expected for the remainder of this year and into 1990. This slowdown in growth should moderate housing activity into 1990, with starts totaling 1.475 million units this year and 1.492 million units in 1990.

As the table above shows, the recent fall in housing starts has not been shared evenly throughout the four regions. Rather, much of the construction slowdown has occurred in the Northeast, where March housing starts hit their lowest rate since September of 1983. The South has also seen starts trend downward over the past few months, falling to their slowest rate in more than a year. Meanwhile, starts in the West remain strong at an annual rate of 395 thousand units. In the Midwest, starts increased by 10.4 percent in March to an annual rate of 307 thousand units, a gain of 17.6 percent over March 1988.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Mar 1989	587	Aug 1988	555
Feb 1989	621	Jul 1988	691
Jan 1989	694	Jun 1988	712
Dec 1988	674	May 1988	701
Nov 1988	650	Apr 1988	716
Oct 1988	718	Mar 1988	679
Sep 1988	691		

Mar 1989
Changes From:

Feb 1989	-5.5%	1987	671
Mar 1988	-11.7%	1988	677

REGIONAL DATA

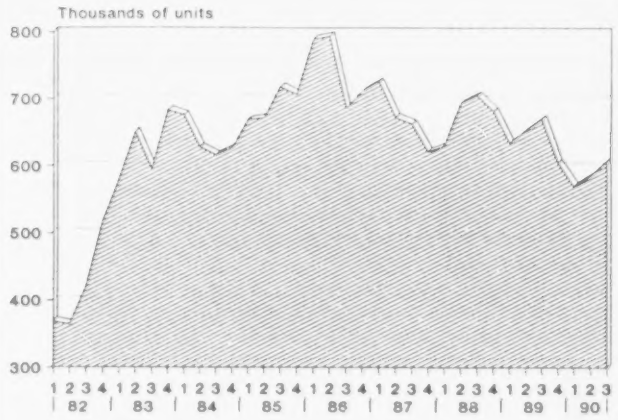
	Northeast	Midwest	South	West
Mar 1989	129	105	199	155
Feb 1989	90	108	228	190
Jan 1989	123	103	261	207
Dec 1988	112	93	263	206
Nov 1988	65	104	254	227
Oct 1988	96	111	274	238
Feb 1988	114	90	282	180
1988	102	97	275	202
1987	134	102	288	140

Mar 89
Changes From:

Feb 1989	43.3%	-2.8%	-12.7%	-18.4%
Mar 1988	13.2%	16.7%	-29.4%	-13.9%

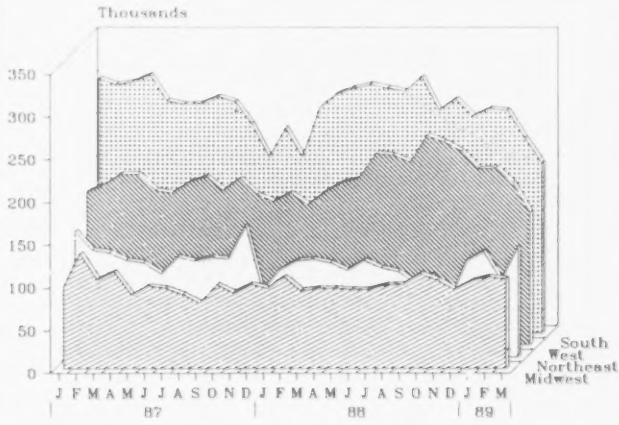
Source: Bureau of the Census, Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 10: NEW HOME SALES BY REGION



Source: The Bureau of Census

Sales of new single-family homes fell for the second consecutive month in March to a seasonally adjusted annual rate of 587 thousand units. The combined two month fall left home sales 15.4 percent lower than the January annual rate of 694 thousand units. Setting annual rates aside, 163 thousand new homes were sold in the first quarter of 1989, almost even with the 1988 first quarter total of 166 thousand units.

Regionally, new home sales appear to have changed dramatically in March. However, government analysts warn against reading too much into one month's figures due to the large margins of error accorded any individual statistic. The two regions to register the greatest losses in March were the South and the West. The South reported a 12.7 percent decline to an annual rate of 199 thousand units, the lowest annual rate since July 1982. Sales in the West dropped 18.4 percent to an annual rate of 155 thousand units. In recent months, new home sales in the West have shown a trend towards softening. However, the March sales rate is considered to be unrealistically low and sales are expected to return to a higher level in April. Even more surprising than the tumble in the West was the 43.3 percent sales increase in the Northeast, where the housing market has been struggling for some time. The 129 thousand unit annual rate was the fastest rate in the Northeast since January 1987. As for the Midwest, with an annual sales rate of 105 thousand units in March (down 2.8 percent from February), new home sales have remained strikingly stable during 1989, particularly when compared to the erratic behavior of home sales in the other three regions.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Mar 1989	3330	Aug 1988	3690
Feb 1989	3480	Jul 1988	3650
Jan 1989	3550	Jun 1988	3800
Dec 1988	3920	May 1988	3620
Nov 1988	3710	Apr 1988	3510
Oct 1988	3680	Mar 1988	3382
Sep 1988	3650		

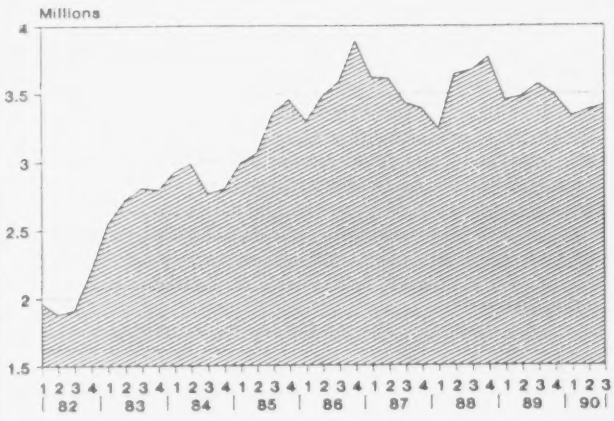
Mar 1989 Changes From:		Annual Totals:	
Feb 1989	-4.3%	1988	3594
Mar 1988	-1.5%	1987	3526

REGIONAL DATA

	Northeast	Midwest	South	West
Mar 1989	540	850	1270	670
Feb 1989	600	920	1310	640
Jan 1989	710	930	1310	630
Dec 1988	700	1010	1500	700
Nov 1988	680	940	1410	680
Oct 1988	640	940	1410	690
Mar 1988	650	870	1270	600
1988	673	929	1350	642
1987	685	959	1282	600
Mar 1989 Changes From:				
Feb 1989	-10.0%	-7.6%	-3.0%	4.7%
Mar 1988	-16.9%	-2.3%	0.0%	11.7%

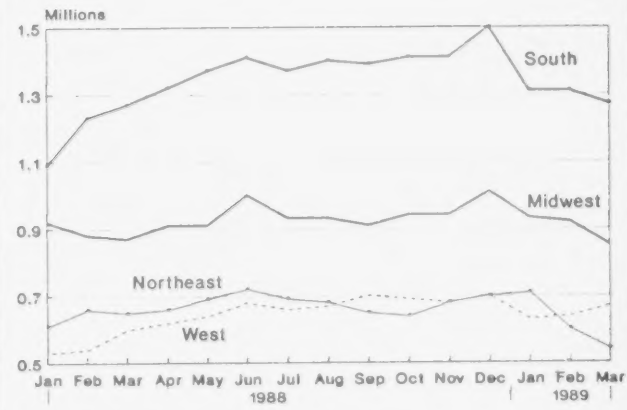
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Sales of existing single-family homes fell 4.3 percent in March to a seasonally adjusted annual rate of 3.33 million units, putting existing home sales at their slowest rate since February of last year, when homes were sold at an annual rate of 3.32 million units. In the first quarter of 1989, existing home sales reached an annual rate of 3.45 million units, down 8.5 percent from the 1988 fourth quarter rate of 3.77 million units, but up 4.6 percent from the first quarter of 1988. The strong finish to 1988 all but guaranteed a slower opening to 1989. However, the forecasted decline in interest rates during the summer months (due to generally slower economic growth) is expected to bolster existing single-family home sales. In fact, we forsee existing home sales remaining fairly stable through the current selling season, reaching an estimated annual rate of 3.48 million homes during the second quarter, and an estimated 3.5 million homes sold for all of 1989.

The March slowdown in existing home sales was shared by three of the four regions; unlike the February decline which was centered in the Northeast. Only the West posted a gain, where sales are rebounding from a 10.0 percent drop in January. As with housing starts, the real soft spot in existing home sales is the Northeast, where sales have fallen by 23.9 percent over the past two months. Sales could continue to fall in this region until prices, which have remained surprisingly firm, begin to soften. Existing home sales fell 7.6 percent in the Midwest, to the lowest rate in over a year. In the South sales fell by 3.0 percent, but were even with the sales rate of a year ago.

SINGLE-FAMILY HOME PRICES

	Median		Average	
	Existing	New	Existing	New
Mar 1989	$93,100	$126,000	$116,900	$152,200
Feb 1989	91,900	120,300	117,800	146,400
Jan 1989	89,700	115,000	113,000	139,300
Dec 1988	88,700	121,000	112,000	147,700
Nov 1988	88,500	110,400	112,400	137,300
Mar 1988	$88,900	$108,900	$111,600	$133,200
1988	89,300	112,500	112,800	138,200
1987	85,600	104,500	106,300	127,200
Mar 1989 Changes From:				
Feb 1989	1.3%	4.7%	-0.8%	3.9%
Mar 1988	4.7%	15.7%	4.7%	14.3%

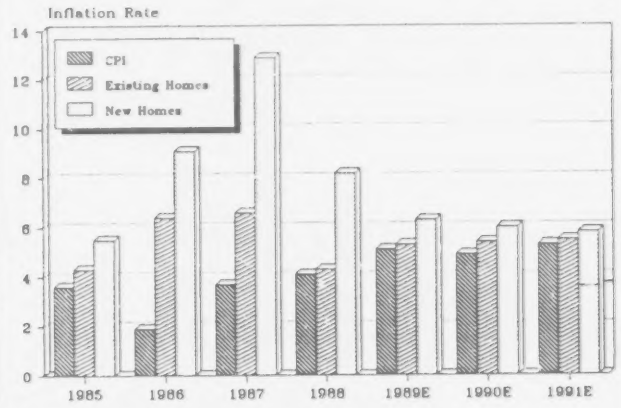
REGIONAL DATA

MEDIAN SALES PRICE OF AN EXISTING HOME

	Northeast	Midwest	South	West
Mar 1989	$146,100	$70,900	$85,700	$135,800
Feb 1989	142,600	69,900	86,700	127,800
Jan 1989	143,800	67,800	82,400	130,700
Dec 1988	143,000	67,700	78,200	128,700
Nov 1988	140,700	67,400	80,400	130,900
Mar 1988	$142,100	$67,200	$83,300	$119,900
1988	143,000	68,400	82,200	124,900
1989	133,300	66,000	80,400	113,200
Mar 1989 Change From:				
Feb 1989	2.4%	1.4%	-1.1%	6.3%
Mar 1988	2.8%	5.5%	2.9%	13.3%

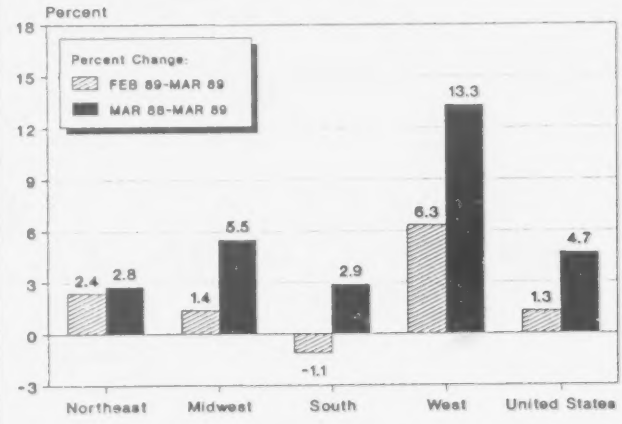
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 13: HOME PRICES



Source: The Bureau of Census; E NAR Estimates

GRAPH 14: EXISTING HOME PRICES BY REGION



Source: NAR Economics and Research; E NAR Estimates

The latest 1.3 percent increase in the median price of an existing single-family home marked the fourth consecutive monthly rise, boosting the median sales price of an existing home to an all-time high of $93,100 in March. The median price of a new home leaped 4.7 percent in March to $126,000, marking a 15.7 percent increase over the $108,900 median sales price of a year ago. This rapid rise in new home prices is expected to moderate later this year, when lower interest rates attract homebuyers purchasing relatively lower priced new homes back into the market.

The rise in the price of an existing single-family home during March was led by the West, where the median price soared 6.3 percent to $135,800, a 13.3 percent increase over the median sales price of a year ago. The West was followed by the Northeast, whose median sales price rose 2.4 percent to $146,100, despite declining rates of sales. However, for the twelve months ending in March, the median sales price rose by only 2.8 percent, illustrating the housing slowdown in that region over the past year. In the Midwest, the median price of an existing home rose 1.4 percent in March to $70,900, 5.5 percent above the median price of a year ago. The only region to experience a decline in existing home prices was the South, where prices have been moving unpredictably for over a year. The latest move, a 1.1 percent decline, put the median sales price at $85,700.

Sean A. Burns
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Beth M. Maerz
Research Associate

HOME EQUITY: HOW MUCH IS THERE, WHO HAS IT, WHERE IS IT?

Home equity -- house value net of mortgage debt -- amounted to about $3.2 trillion in the U.S. in 1985. Median home equity (over all homeowners) was about $43,000 in 1985, constituting the largest portion of the typical homeowner's wealth. This store of savings enhances a homeowner's ability to trade up to better housing or allows them to pull some equity out when they move. It also serves as a source of borrowing through second mortgages or home equity lines of credit. Moreover, the one-time exclusion of $125,000 capital gains on primary residences for those 55 years or older encourages homeowners to use home equity as a vehicle for long-term savings and then to establish the most suitable housing arrangement for their retirement years (i.e., trade down to smaller housing, or liquidate home equity and rent). The amount of home equity held is affected by house price inflation, but it clearly also depends on the amount of mortgage debt the homeowner decides to take. The level of mortgage debt taken is partly due to economic necessity, but also is influenced by the ability to deduct mortgage interest.

Homeownership and Home Equity

The newly released national American Housing Survey (AHS) for 1985 contains much more information on homeowners' mortgage instruments than in previous AHS surveys. In addition to more detail on the terms of mortgage loans, the 1985 survey, for the first time, collects this mortgage information for all homeowners instead of merely recent movers. This allows the calculation of outstanding mortgage debt as of 1985 and, consequently, home equity for all homeowners.[1]

Table 1 summarizes median amounts of home equity, as well as other indicators, nationally and by age, income and region. Of the 88.4 million households in 1985, there were 56.1 million homeowners, for a homeownership rate of 63.5 percent. The table reveals how sharply homeownership rises with both age and income. Less than 40 percent of households under 35 years old own their homes. The rate rises sharply thereafter, peaking at nearly 80 percent for those 55-64 years old, whereafter it falls as many elderly homeowners alter their living arrangements by becoming renters. The homeownership rate for households with below $10,000 income is 42 percent. The rate rises steadily until peaking at nearly 90 percent for incomes $50,000 and above.

Median home equity in 1985 for the nation was $43,285. Homeowners 55-64 years old had the highest median home equity. Clearly, younger homeowners have less home equity because they have more mortgage debt and have been homeowners fewer years; but median home equity of the 10 million homeowners less than 35 years old is nonetheless about $20,000. The drop in median home equity after 65 years of age, together with the drop in the homeownership rate after 65, document that many homeowners liquidate some or all of their home equity after retirement.

Not surprisingly, home equity holdings rise with income. Median home equity in 1985 was $35,000 for homeowners below $20,000 income, rising steadily with income until reaching $100,000 for homeowners with income $100,000 and above.

The last column of Table 1 shows that nationally, 42.7 percent of homeowners had no mortgage debt at all in 1985 (i.e., 57.3 percent had at least some). The percent with mortgage debt and the median amount of debt are, of course, much higher for younger homeowners. By retirement age, most homeowners own their homes free-and-clear: only 17 percent of homeowners 65 and over had any mortgage debt in 1985. The generally lower incomes of elderly homeowners with no mortgage debt help explain the low percentage of lower-income homeowners that hold mortgage debt.

The bottom panel of Table 1 summarizes regional disparities in homeownership and home equity holdings. The Northeast and the West have lower homeownership rates than the other regions, but their median holdings of home equity are about 60 percent higher. These two regions have experienced periods of quite rapid house price appreciation, leading to increases in home equity.

Distribution of Home Equity by Age, Income and Region

Data on median holdings of home equity are suggestive, but its distribution over particular dimensions provides a more complete picture. Tables 2, 3 and 4 present the national distribution of home equity over three dimensions: household age, income and region, respectively. Not surprisingly, older homeowners possess a substantial share of the nation's home equity. One half, or 6.9 million, of homeowners 65 or over held at least $50,000 in home equity in 1985; another 4.9 million held between $20,000 and $50,000. Home equity holdings are also substantial for middle-age homeowners. About half (54 percent) of the 20.1 million homeowners between 45 and 64 years old had at least $50,000 in home equity; another 6.3 million (31 percent) held between $20,000 and $50,000.

Table 1

Median Home Equity, 1985
By Household Age, Income, and Region
(Households in Thousands)

Household Class	Number of Households	Homeownership Rate	Number of Homeowners	Median Home Equity	Percent w/ Mortgage
All HHs	88,425	63.5%	56,145	$43,285	57.3%
Age:					
<35	25,521	39.1	9,983	20,488	84.9
35 - 44	18,013	68.0	12,243	40,000	84.2
45 - 54	12,818	75.2	9,637	50,000	67.3
55 - 64	13,177	79.3	10,447	54,537	43.3
65 - 74	11,284	77.6	8,757	50,000	21.8
75+	7,612	66.7	5,077	45,000	8.7
Income ($000):					
<10	20,073	42.3	8,499	34,999	26.0
10 - 20	20,243	53.5	10,821	35,000	41.6
20 - 30	17,139	65.2	11,182	40,000	58.9
30 - 40	11,913	75.6	9,011	42,300	70.0
40 - 50	7,183	84.1	6,041	50,000	73.9
50 - 100	10,057	89.1	8,960	65,000	78.8
100+	1,817	89.8	1,632	100,000	75.7
Region:					
Northeast	18,729	60.6	11,347	59,000	54.2
Midwest	22,142	66.3	14,673	37,000	55.8
South	30,064	66.1	19,858	36,136	54.8
West	17,490	58.7	10,267	60,000	67.6

Source: American Housing Survey, 1985.

Table 2

Home Equity By Household Age, 1985
(Thousands of Homeowners)

	Household Age							
Home Equity ($)	<35	35-44	45-54	55-64	65-74	75+	Total	Percent
0 or Negative	563	388	216	138	59	9	1,373	2.5
1 - 19,999	4,247	2,580	1,333	1,313	1,228	751	11,451	20.4
20,000 - 49,999	3,219	4,353	3,096	3,190	2,928	1,998	18,784	33.5
50,000 - 99,999	1,472	3,359	3,327	3,912	3,142	1,619	16,832	30.0
100,000 - 249,999	434	1,366	1,426	1,691	1,232	609	6,757	12.0
250,000+	48	197	239	203	169	91	948	1.7
Total	9,983	12,243	9,637	10,447	8,757	5,077	56,145	100.0

Table 3

Home Equity By Income, 1985
(Thousands of Homeowners)

	Income ($000)							
Home Equity ($)	<10	10-20	20-30	30-40	40-50	50-100	100+	Total
0 or Negative	127	295	373	226	130	183	39	1,373
1 - 19,999	2,399	2,722	2,487	1,790	1,037	910	106	11,451
20,000 - 49,999	3,447	3,914	3,951	3,126	1,862	2,263	221	18,784
50,000 - 99,999	1,945	3,033	3,184	2,789	2,215	3,216	450	16,832
100,000 - 249,999	536	773	1,049	979	734	2,091	596	6,757
250,000+	46	83	138	101	63	297	221	948
Total	8,499	10,821	11,182	9,011	6,041	8,960	1,632	56,145

Table 4

Home Equity by Region, 1985
(Thousands of Homeowners)

	Region				
Home Equity ($)	Northeast	Midwest	South	West	Total
0 or Negative	219	325	586	243	1,373
1 - 19,999	1,431	3,358	5,046	1,615	11,451
20,000 - 49,999	3,129	5,971	7,227	2,457	18,784
50,000 - 99,999	3,964	4,214	5,211	3,444	16,832
100,000 - 249,999	2,293	740	1,560	2,165	6,757
250,000+	311	65	229	343	948
Total	11,347	14,673	19,858	10,267	56,145

Table 3 distributes home equity by income. In general higher-income homeowners hold more home equity. But there is also a substantial number of lower-income homeowners who possess significant home equity. For example, 30 percent of the 8.5 million homeowners with less than $10,000 income had $50,000 or more in home equity in 1985. This is largely due to the many "home-rich and cash poor" elderly homeowners.

Table 4 distributes home equity by region. Well over half of the homeowners with less than $20,000 home equity are less than 45 years old. The Northeast and the West regions contain the bulk of high-equity homes: two-thirds of the 7.7 million homes with at least $100,000 home equity were in these two regions in 1985, even though less than 40 percent of all homes were located there.

by
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Director of Housing Research

1. The AHS contains detailed information on the first and second mortgages associated with the surveyed residence, including current mortgage interest rates, when the mortgages were acquired, their terms, and the mortgage amounts when acquired. This allows for calculating the outstanding balance in 1985 on each of the mortgages by essentially paying down each mortgage between acquisition and 1985. Total mortgage debt is the sum of these two balances, and home equity is current market value on the home net of total mortgage debt.

REDUCED TAX BENEFITS FOR HOMEOWNERSHIP MEAN REDUCED HOMEBUYING

Federal income tax rates were reduced substantially by the Tax Reform Act (TRA) of 1986. Lower tax rates, in turn, meant that each dollar of mortgage interest expense deducted on their income tax returns saved homeowners less taxes than they did before TRA. NAR's National Homeownership Survey conducted in 1986 was designed in part to find out how such reduced tax benefits would affect homebuying plans.

NAR'S NATIONAL HOMEOWNERSHIP SURVEY

A nationally representative sample of households--including both renters and owners--was asked whether or not they planned to buy a home within the next ten years. Those who answered "yes" were then asked whether or not their plans would be altered by the reduced tax benefits from deducting mortgage interest expense because of TRA's rate reductions.[1] The following table shows the percentages of prospective homebuyers who said their purchase plans would be altered as well as a breakdown by types of responses.

EFFECTS ON HOMEBUYING DECISION FROM REDUCED MORTGAGE INTEREST DEDUCTIBILITY TAX BENEFITS

Response to Tax Rate Reductions	ALL Prospective Homebuyers*	Current Renters	Current Owners
Planned Purchase Would Be Altered	**36.7%**	**43.8%**	**32.5%**
Delay Purchase Temporarily	20.7	33.6	13.0
Delay Purchase Indefinitely	7.3	2.1	10.5
Buy Less Expensive House	13.0	12.7	13.2
Rent Instead of Buy	2.8	5.0	1.4
Planned Purchase Would Not Be Altered	**63.3**	**56.2**	**67.5**

* Respondents were permitted to indicate multiple ways that their purchase plans would be altered; therefore, the percent of prospective homebuyers saying they would alter their purchase plans is less than the total for the four individual categories of responses.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®, National Homeownership Survey, Unpublished Data (1986).

TYPES OF RESPONSES TO REDUCED TAX BENEFITS

As shown in the above table, over one-third of all prospective homebuyers said they would alter their planned purchase of a house as a result of reduced tax benefits from itemizing mortgage interest expenses. However, current renters were more likely to alter their planned purchases than were current owners (43.8% vs. 32.5%).

Overall, one out of every five (20.7%) prospective homebuyers would temporarily postpone buying, 13 percent would buy a less expensive unit, 7.3 percent would stay in their current dwelling, and 2.8 percent would rent their next unit rather than buy as planned.

Current renters and current owners differed markedly in how they said they would alter their planned home purchases. More than three out of four renters who said they would alter their planned home purchases would delay them until they "get more money for a downpayment." Not surprisingly, only two out of five affected owners would delay their purchases for this reason.

Prospective homebuyers who currently rented were more than twice as likely to delay their home purchases temporarily as to buy less expensive homes (33.6% vs. 12.7%). Current owners, however, were as likely to buy less expensive homes as to delay their purchases temporarily (13.2% vs. 13.0%). Moreover, current owners were five times as likely as current renters to delay indefinitely their planned purchase of another house (10.5% vs. 2.1%).

DIFFERENCES AMONG PROSPECTIVE HOMEBUYERS RESPONDING DIFFERENTLY TO REDUCED TAX BENEFITS FROM HOMEOWNERSHIP

Response to Tax Rate Reductions	Current Renters			Current Owners		
	Income	Saving Rate	Age	Income	Saving Rate	Age
Planned Purchase Would be Altered	**$22,030**	**3.4%**	**34.5**	**$26,801**	**5.4%**	**44.2**
Delay Purchase Temporarily	22,766	3.4	34.5	25,945	6.1	37.4
Delay Purchase Indefinitely	25,156	6.1	42.5	23,977	4.6	46.7
Buy Less Expensive House	19,531	2.9	36.9	29,247	5.5	48.9
Rent Instead of Buy	16,842	2.6	32.4	39,306	5.5	45.0
Planned Purchase Not Altered	**22,541**	**4.6**	**36.7**	**32,583**	**6.3**	**41.4**

SOURCE: NATIONAL ASSOCIATION OF REALTORS® National Homeownership Survey, Unpublished Data (1986)

WHY PROSPECTIVE HOMEBUYER RESPONSES DIFFER

Renters who said they would alter their home purchase plans because of reduced tax savings from the mortgage interest deduction are most distinguishable by their low incomes and low savings rates. Indeed, the lower the incomes and savings rates the more drastic the adjustment. Renters who would temporarily delay their purchases had an average income of $22,766 and savings rate of 3.4 percent as compared with an income of $22,541 and a savings rate of 4.6 percent for renters with unaltered purchase plans. Renters who would buy a less expensive house than planned had an average income of $19,531 and a savings rate of 2.9 percent; renters who would rent their next unit instead of buying as planned had an average income of $16,842 and a savings rate of 2.6 percent.

Current owners who said they would alter their planned house purchases because of reduced tax savings from mortgage interest deductibility would appear to do so for quite different reasons than would current renters. Whereas current renters opting to rent rather than buy their next homes because of reduced tax benefits tend to be young, single households with low incomes and low saving rates, current owners who said they would rent rather than buy tend to be older, married households with high incomes and high saving rates.

SUMMING UP

Writing in 1986 shortly after TRA was enacted, a leading housing economist attempted to foresee what effects reduced income tax rates would have on homeownership:

> Clearly, tax advantages are not the only reason for 4buying a home, and most households will proceed to act as if nothing had changed. But the loss of these tax benefits could deter some from doing so, or at least delay them.[2]

Based upon results from NAR's National Homeownership Survey, the writer was prescient because most prospective homebuyers did in fact say they would be unaffected by the loss of tax savings from the mortgage interest deduction. However, the proportion saying their planned home purchase would be adversely affected was sizeable. Indeed, over one-third would delay their purchase, buy a less expensive home, or rent instead of buying.

Moreover, households would be affected quite differently depending on their particular stage in the life cycle and whether first-time or repeat homebuyers. Prospective first-time homebuyers were more likely to delay their planned purchases, for example, while prospective repeat homebuyers were more likely to be deterred from trading-up--instead, remaining in their current homes, buying smaller homes, or even becoming renters.

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1. Surveyed households were told that TRA would reduce tax savings, on average, from about $35 to about $15 for every $100 of mortgage interest expense deducted.

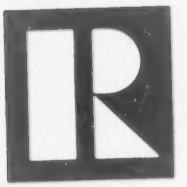
2. Daniel N. Chambers, "The Homeowner Market," Chapter 1 in Homebuilding After Tax Reform (Washington, D.C.: National Association of Homebuilders, 1986), p. 6.

U.S. ECONOMIC OUTLOOK

MAY 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.4	89.1	89.2	89.3	89.4	90.1	90.2	90.3	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5000	5117	5206	5281	5354	5440	5514	5589	4527	4864	5239	5552	5901
% Change	7.6	9.7	7.2	5.8	5.6	6.6	5.6	5.6	6.8	7.5	7.7	6.0	6.3
% Change (w/out inflation)	2.4	5.5	2.2	2.2	1.8	2.0	1.5	1.7	3.4	3.9	3.1	1.8	1.9
Consumer Price Inflation (CPI)	4.4	5.4	5.9	4.6	4.6	5.0	4.8	4.8	3.7	4.1	5.1	4.9	5.3
GNP Inflation (GNP Deflator)	5.3	3.9	4.7	3.6	3.7	4.5	4.0	3.8	3.3	3.4	4.5	4.0	4.3
Unemployment Rate - Civilian	5.3	5.2	5.2	5.1	5.1	5.1	5.3	5.4	6.2	5.5	5.2	5.3	5.6
Civilian Employment-Household Basis (millions)	115.8	116.9	117.4	117.9	118.4	118.7	119.0	119.3	112.4	115.0	117.6	119.1	120.1
Percent change	2.2	3.7	1.7	1.8	1.5	1.2	0.9	1.0	2.6	2.3	2.3	1.3	0.8
Index of Industrial Production	139.9	141.0	142.0	142.7	143.4	144.0	144.4	144.9	129.8	137.2	142.3	144.7	146.7
Manufacturing Capacity Utilization	84.4	84.7	84.9	85.1	84.9	84.9	84.7	84.4	81.0	83.6	84.9	84.5	83.1
Domestic Auto Sales	7.5	6.9	7.2	7.1	7.2	7.2	7.2	7.1	7.1	7.5	7.1	7.2	7.0
Federal Tax Receipts (NIPA) as % of GNP	19.8	20.0	20.4	20.4	20.4	20.9	20.8	20.8	20.2	20.1	20.3	20.8	20.8
Federal Expenditures (NIPA) as % of GNP	23.0	23.0	22.8	22.7	22.7	22.8	22.8	22.8	23.7	23.0	22.8	22.8	22.7
Deficit(NIPA)	-157.5	-151.7	-125.3	-123.3	-121.4	-106.6	-107.6	-109.1	-157.8	-142.4	-130.4	-108.8	-110.6
as % of GNP	-3.2	-3.0	-2.4	-2.3	-2.3	-2.0	-2.0	-2.0	-3.5	-2.9	-2.5	-2.0	-1.9
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4874	4496	4503	4620	4519	4371	4397	4448	4648	4651	4535	4389	4443
Percent change – year ago	9.6	-2.0	-3.6	-1.5	-7.3	-2.8	-2.4	-3.7	-1.4	0.1	-2.5	-3.2	1.2
Existing Single-family Home Sales (thousands)	3770	3453	3480	3570	3490	3335	3380	3410	3526	3594	3498	3360	3405
Percent change – year ago	11.2	4.6	-4.5	-2.5	-7.4	-3.4	-2.9	-4.5	-1.1	1.9	-2.7	-4.0	1.3
Housing Starts (thousands)	1559	1517	1470	1511	1473	1485	1457	1488	1634	1496	1493	1475	1492
Percent change – year ago	1.7	2.7	-0.7	3.1	-5.5	-2.1	-0.9	-1.5	-9.8	-8.5	-0.2	-1.2	1.1
Single-Family Units	1138	1076	1055	1083	1060	1068	1049	1070	1157	1089	1068	1061	1070
Percent change – year ago	4.5	-1.9	-0.7	2.1	-6.8	-0.8	-0.6	-1.2	-2.2	-5.8	-1.9	-0.7	0.9
Multi-Family Units	420	441	416	429	413	417	409	418	477	406	425	415	422
2-4 Family Units	65	57	53	55	53	54	53	54	66	59	55	53	54
Percent change – year ago	16.0	0.6	-6.9	-3.5	-18.8	-5.5	-1.7	-2.4	-22.6	-10.3	-7.6	-2.3	1.8
5+ Family Units	355	385	362	374	360	363	356	365	412	347	370	362	368
Percent change – year ago	-8.2	18.8	0.3	7.0	1.4	-5.5	-1.7	-2.4	-24.4	-15.7	6.6	-2.3	1.8
New Single-family Home Sales (thousands)	682	634	653	670	605	570	585	607	671	677	641	587	624
Percent change – year ago	9.8	0.6	-6.3	-4.7	-11.3	-10.1	-10.4	-9.4	-10.5	0.9	-5.4	-8.4	6.3
Mobile Homes Shipped (thousands)	223	223	234	246	244	244	241	245	233	217	237	243	243
HOME PRICES													
Existing Home Prices - Median $(1000)	88.7	91.6	93.8	95.1	95.6	96.7	98.4	99.5	85.6	89.3	94.0	99.1	104.6
Percent change – year ago	4.4	4.3	5.5	5.4	7.8	5.6	4.9	4.6	6.6	4.3	5.3	5.4	5.5
New Home Prices - Median $(1000)	114.9	120.4	118.5	119.7	119.7	122.0	124.3	127.1	104.0	112.5	119.6	126.7	134.1
Percent change – year ago	2.8	6.6	4.9	4.2	4.2	1.3	4.9	6.2	13.0	8.2	6.3	6.0	5.8
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.6	10.9	11.2	11.1	10.8	10.7	10.6	10.5	10.2	10.5	11.0	10.6	10.3
1-year ARM (without buydown)	8.5	8.8	9.1	8.9	8.7	8.6	8.5	8.4	8.5	8.5	8.9	8.5	8.1
Corporate AAA Bond Rate	9.5	9.7	10.2	10.0	9.9	9.7	9.7	9.6	9.4	9.7	10.0	9.9	9.6
Government Bond Rate	9.0	9.0	9.4	9.3	9.1	9.0	9.0	9.0	8.6	9.0	9.2	9.0	8.8
Short-Term Interest Rates													
Federal Funds Rate	8.5	9.4	10.0	9.8	9.5	9.0	8.6	8.5	6.7	7.6	9.7	8.8	7.5
3-month T-Bill Rate	7.7	8.5	9.3	9.1	8.7	8.4	8.1	8.0	5.8	6.7	8.9	8.1	6.5
Prime Rate	10.2	11.0	11.8	11.6	11.2	10.8	10.4	10.2	8.2	9.3	11.4	10.4	9.5
Discount Rate	6.5	6.7	7.0	7.1	6.9	6.7	6.5	6.5	5.7	6.2	7.0	6.8	6.3
Value of the U.S. Dollar (Trade-Weighted Avg.)	93.0	96.0	96.6	94.2	92.7	91.1	89.4	87.5	96.9	92.8	94.9	88.4	81.6
Percent change	-17.6	13.5	2.8	-9.5	-6.4	-6.8	-7.4	-8.2	-13.6	-4.3	2.3	-6.8	-7.6

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.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